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Economic and Monetary Union: A Test for US-European Relations

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The start of Economic and Monetary Union (EMU) has been a watershed event with significant implications for European affairs and Europe's place in the wider world. And while some aspects of EMU are, by necessity, shrouded in uncertainty, the signs are that this gamble has paid off. Let's be clear about this: EMU has been a success. The doomsayers got it wrong. It has boosted investment and innovation in the euro-zone, strengthened cooperation among its participants on budgetary policies, facilitated progress toward the creation of an integrated European capital market and advanced the broader process of economic reform.

Given the substantive importance of the issues involved, it is logical that EMU has, for some years now, been a hotly debated topic. Unfortunately, however, this active debate has largely ignored EMU's effects on the outside world. And yet, analysing these external repercussions is vital. More specifically, EMU is testing US-European relations across a variety of issue areas: monetary policy, financial diplomacy and trade relations.

In essence, the new international financial order will reduce the asymmetrical advantages that the US has enjoyed and which stemmed from the dollar's uniquely dominant role. These benefits include preferential access to cheap money from abroad, a partial insulation from the discipline that financial markets put on governments and the possibility to conduct so-called "dollar diplomacy". For decades, US governments have tried, with varying degrees of success, to use the dollar's status and exchange rate as an instrument in the pursuit of other economic objectives including the trade balance. Furthermore, since financial issues are intimately linked to those of power politics - look, for example, at policy-making towards Russia or Indonesia - there may also be spillovers into "traditional" foreign and security policy.

US perceptions of EMU

Since the stakes are so high, it is fitting to ask whether EMU is, on balance, a help or hindrance to effective transatlantic cooperation. To answer this, let us look at what the dominant American view is of EMU at a strategic level. An important proviso must be that few American policy-makers are thinking about EMU at all. When asked, European diplomats in Washington vent their frustrations regarding the lack of interest on the part of their US colleagues. The latter for their part concede that it does not come up on their proverbial “radar screens”. In addition, American foreign policy strategists have maintained a studied silence on the matter. Consequently, the debate, such as it is, has been dominated and its terms set by the US Treasury.

Treasury thinking actually takes place along two separate lines. On the one hand, there is considerable scepticism whether EMU can function with existing levels of labour mobility and fiscal transfers. There is also a lot of talk that EMU, a project of dubious economic merit, will distract policy-makers’ attention from what really matters: structural reform.

On the other hand, there is the strand, usually emphasised in public, which says that what is good for Europe is also good for the US. While true at an abstract level, this is also somewhat banal since EMU raises important policy challenges.

Actually, broad US attitudes to EMU have followed a pattern that is eerily familiar to those that have followed US perceptions of EU affairs in general. As William Wallace and Jan Zielonka put it: “First inattention, then assertions that it cannot succeed, then warnings of danger once success appears imminent.”[1] For decades, the US position on European integration has suffered from a degree of schizophrenia. To acknowledge this is not to indulge in anti-American rhetoric. Many Americans themselves recognise that whilst American governments have long supported the idea of European unification, they have also reverted to classic “divide-and-rule” practices when expedient.

US leaders have often voiced their frustrations at the slow pace of the integration process and the unwieldy Brussels arrangements it relied upon. “Why can’t they simply become like us?” has been their underlying - and deeply ahistorical - exhortation. However, when a single European voice eventually arose and said something of which Washington disapproved, America’s reaction invariably blended surprise with indignant disapproval. EMU will not change this underlying ambivalence which is built into the transatlantic relationship.

Dispelling the myth of EMU’s anti-American objective

Peter Rodman, of the Nixon Center in Washington DC, argues that “it is a commonplace that the EMU reflects a new stage in the desire to build the EU into an

1 W. Wallace and J. Zielonka, “Misunderstanding Europe”, Foreign Affairs, vol. 77, November-December 1998.

economic and financial equal to the US." Its success will mean "freeing Europe from disadvantageous subordination to the dollar and subjecting the US, finally, to some of the same financial discipline which it hitherto escaped."[2] Martin Walker essentially agrees: "It will involve a sobering, although not humiliating, decline in the dollar's prestige - a small price to pay for the benefits involved, if the adjustment process is pursued with care and forethought."[3] On that point, Europeans and Americans are in agreement.

Yet Rodman also makes another, more contentious point, which harks back to conservative attitudes towards European integration that have a long pedigree. He claims that European policies in general and EMU in particular have been conceived, in part, as anti-American moves. In line with many analysts of the realist persuasion, Rodman highlights the possibility of the emerging threat of a new hegemon; with EMU being merely the latest tool that Europeans deploy to distance themselves from the US. He goes out of his way to deplore the self-indulgent "infantile disorder" of anti-Americanism and warns of the dangers it presents to Atlantic unity.[4]

In truth, the situation need not be so dramatic. But since this view of EMU being actually or potentially anti-American is so prevalent, it needs to be tackled head on. To do this, a brief historical detour is necessary. It will show that EMU was never conceived as an anti-American move, nor even aimed at minimising the asymmetrical advantages the US enjoyed. A reduction of these advantages is merely the unintended - yet for Europeans beneficial - by-product of a project that clearly found its origins in intra-European developments.[5]

First among these is the aim not just to "finish the single market" as Eurocrats often stress, but also to solve the dilemma of combining the Exchange Rate Mechanism (ERM, a system of fixed, but adjustable currency pegs) with the free flow of capital. Back in 1987, Tommaso Padoa-Schioppa, a Commission official, had already predicted that this combination would lead to damaging speculative attacks on the weaker currencies in the system. The only way for the ERM to survive the liberalisation of capital flows, he argued in a seminal report that convinced Commission President Jacques Delors,[6] was to move to full monetary union. Subsequent attacks on the Italian lira, the British pound and the French franc in 1992 and 1993

2 P. Rodman, Drifting Apart? Trends in US-European Relations (Washington DC: The Nixon Center, 1999).

3 M. Walker, "The Euro: Why it is Bad for the Dollar But Good for America", World Policy Journal, vol. 15, Fall 1998.

4 Rodman, Drifting Apart? Other realists have echoed this alarm, see W. Pfaff "The coming clash of Europe with America", volume 15, World Policy Journal, Winter 1998/1999; R. Dale, on the other hand, has identified the "small cottage industry of American experts scouring European pronouncements on the euro and other moves toward a stronger Europe, almost in the hope of finding anti-American sentiments that could give the US cause for offense". International Herald Tribune, 17 September 1999.

5 See the special core issue on "The Euro: Looking Ahead" in The International Spectator, vol. 33, no. 2, 1999.

6 T. Padoa-Schioppa, Efficiency, Stability and Equity. A strategy for the Evolution of the Economic System of the European Community (Oxford: Oxford University Press, 1987).

proved that Padoa-Schioppa had been right.

Of course, the Europeans had talked about the merits of a monetary union since the late 1960s. But despite a steady stream of reports and blueprints, the project had lacked political commitment and therefore remained in the realm of academic aspirations. It was something people referred to at seminars, but was quite distinct from practical politics.

All that changed in November 1989. At that time, the prospect of a hegemonic united Germany moving away from its commitment to the West, and the EC in particular, gripped Parisian imaginations. But true to the maxim of French foreign policy that whatever the problem, the answer is always “Europe”, President Fran‡ois Mitterrand offered Helmut Kohl, the West German Chancellor, a quid pro quo. He essentially traded his assent to German unification for a West German accord to fix a date for an IGC on EMU. That was when Kohl crossed the Rubicon, as he realised that EMU was a price well worth paying to allay fears among Germany’s neighbours - however misplaced these might have been. Mitterrand got half the Deutschmark, Kohl the whole of Germany.

The US, or rather the alleged need to balance American preponderance, played no salient role in the calculations of Europe’s leaders in that crucial phase. Therefore, this charge of EMU being anti-American in its origins and objectives is misplaced. American conservatives who nonetheless insist on this flawed argument should remember that it could, if repeated often enough, become a self-fulfilling prophecy.

Instead, the US should drop the paranoia and ambivalence and welcome Europe as a truly equal partner. Real allies are rare in today’s world and on the grand strategic issues, the Europeans are closer to the US and have more diplomatic and economic clout to offer than any other country or group of countries. “The Europeans - with all their evident flaws and weaknesses - are the US’ only dependable partners, sharing America’s values and burdens.”[7]

If and when Europe is recognised for what it is, it will also become evident that more respect for European views in Washington is desirable and possible. This means a bit less boasting about alleged or real US successes and less lecturing on Europe’s actual or imagined defects. Consider for instance Mortimer Zuckerman’s conclusion after having extolled the virtues of the US economic model and having sharply attacked the performance of the European economies: “France had the seventeenth century, Britain the nineteenth and America the twentieth. It will also have the twenty-first.”[8] This self-satisfaction may be excessive in light of the less than impressive US record on crime, healthcare and social cohesion. But it is particularly hard to combine with incessant American emphasis that it can no longer bear the economic burden of global responsibilities, that it is running a trade deficit for the benefit of the whole world and that “Europe should pay more”.

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7 Wallace and Zielonka, “Misunderstanding Europe”.

8 M. Zuckerman, “A Second American Century”, Foreign Affairs, vol. 77, May-June 1998.

What the Europeans need to do: appoint a Mr. Euroland

EMU is making Europe more coherent. If handled well, it could empower Europe's leaders, reducing their dependence on the dollar. It will force the Americans to take European preferences and positions more seriously. Not immediately, that is true, but the trends clearly favour this interpretation.

Against this background it is tempting, from a European perspective, to believe that coming to terms with EMU's external effects is mainly a task for non-Europeans. But this view is misguided. EMU's participants will also have to enact serious reforms in policies, attitudes and institutions to make the management of the euro's external repercussions a success. More specifically, the Europeans need to rethink their external representation and create the job of a "Mr. Euroland", an individual who can speak authoritatively for the euro-zone.

The case for Mr. Euroland starts from the assessment that the euro is enabling Euroland to raise its stature in global financial diplomacy. After all, EMU's participants now share a single external balance of trade, as well as a single monetary policy. Over time, the euro will become a currency with a significant international role, challenging though not replacing the dollar. And the rest of the world - increasingly - expects the euro-zone to speak with a single voice in the management of financial crises such as those that wracked Asia in 1997-98.

But the handling of those crises led to some harsh words between the US and European governments, with each side having very different recollections. The Americans remember how the then US Deputy Treasury Secretary, Larry Summers, shuttled around the region, and how his department provided the intellectual input for the IMF rescue packages. Many Americans felt that the Europeans were conspicuously absent from the region, hopelessly divided and excessively focused on their own internal priorities. The Europeans, in contrast, remember that they were asked to pay a great deal for US-inspired measures, without having had much say over their conception. Most Europeans also reckoned that the IMF packages for the Asian countries were too fiscally restrictive.

To reduce the scope for such disputes and misunderstandings, Euroland needs to develop a strategic view of its wider responsibilities in co-managing the global economy.[9] To their credit, many US policy-makers want the Europeans to overcome their internal divisions and nominate a political representative that could speak for the euro-zone. Evidently, the US attitude towards such an authoritative spokesman would depend on what he or she said. But the creation of such a post would - on balance - facilitate the striking of bargains and increase the chances of making them stick.

Euroland thus needs a political figure who could operate alongside ECB president Wim Duisenberg. For obvious reasons, smooth coordination between the two will be vital. In particular, both will need to sing from the same hymn sheet

9 P. C. Padoan, "Is European Monetary Union Endogenous?", The International Spectator, vol. 34, no. 3, 1999.

– even if their functions and responsibilities are different. In this respect, the euro-area needs to learn from the successful US double-act of Federal Reserve Chairman Alan Greenspan and Treasury Secretary Larry Summers. Creating a single authoritative spokesperson for Euroland could therefore help to avoid the cacophony on the exchange rate that beset the euro-area during the first half of 1999. Only Mr Euroland should make pronouncements on the euro's exchange rate, just as in the US only the Treasury makes statements on the dollar.

Crucially, the point of such a post should not be merely to deal with the old American grumbles about European divisions and provincialism. Many Europeans also believe that their existing arrangements are unsatisfactory and need to be reformed. Now that the Asian financial crises are history, and the euro has emerged as a solid currency, the time has come for Europe to make its presence felt at the high tables of global finance.

Until now, Europe's ministers and officials have merely tried to forge "common understandings" on international financial questions. Such efforts are necessary but not sufficient: cooperation of this kind remains slow, reactive and often vacuous. Furthermore, the current procedures for external representation show that Euroland is unable to make painful choices. In G-7 negotiations, for example, the euro-zone is represented not only by three national central bank governors (France, Germany and Italy) and the ECB president, but also by the finance minister of the country that holds the rotating EU presidency and the Commissioner in charge of monetary affairs "to lend assistance". This unwieldy arrangement has, predictably, drawn a negative US reaction. The Americans point out, with some justification, that despite the lofty talk of European integration, there are now more Europeans around the table at every international meeting.

So who exactly should be the political voice of Euroland? The Commissioner in charge of EMU (Pedro Solbes), say many Euro-enthusiasts. But in reality any Commissioner, however brilliant, lacks political clout; the larger member states, especially, would simply not accept that he should speak for Euroland. Nor does public opinion seem ready for such a step. Because of the sensitivity of the issues involved, this is clearly a responsibility that should reside in the Council, where the member-states call the shots. In addition, the fact that four out of 15 EU members are not (yet) in EMU also makes it harder for an EU Commissioner to speak authoritatively on behalf of a (very important) subset of the Union.

However, the alternative of the rotating presidency of the Council is also problematic. It lacks continuity, expertise as well as political credibility. Many non-Europeans and especially the Americans see it as a complicating irrelevancy. They may well have a point. The EU presidency, like that of the informal euro-11, simply lacks the necessary prominence in the eyes of the outside world.[10] No matter how

10 Euro-11 is the informal body which groups together the finance ministers of the euro-zone. Its presidency rotates.

able the relevant minister or how misguided the negative views of non-Europeans, Americans especially, the fact is that not all financial heavyweights will accept the finance minister of a small EU country as a serious interlocutor. There is also the problem that when the rotating president arrives at international meetings, he comes with a carefully prepared position from which he cannot budge without further consultations with the other finance ministers. This rigidity is not exactly conducive to flexible diplomacy, and certainly not in dealing with international financial crises.

So we need a “Mr. Euroland”, appointed because of his personal qualities and answerable to the finance ministers of the euro-zone. The job would be comparable to the new post of EU High Representative for Common Foreign and Security Policy. The US Treasury Secretary or the IMF Managing Director could call Mr. Euroland if, say, Russia defaulted, or if they simply wanted to review the global financial scene. He should be located in the Council secretariat with a small supporting staff that should help him with policy development. The euro-11 council, would give Mr. Euroland a mandate to negotiate agreements with other political authorities. Afterwards, the euro-11 should then speedily ratify (or reject) any international agreement thus negotiated.

This proposal would require a matching reform of the euro-11 council, so as to take on the power to make formal decisions affecting the workings of EMU. If a single Euroland representative put forward a common position in international fora such as G-7 meetings, it would gain the kind of credibility and strength that it evidently lacked during the Asian crises. Over time, it would make also sense for Mr. Euroland to become the euro-zone’s political representative at the IMF.

Evidently, EU governments are some way away from creating the post of Mr. Euroland. Distinctive national outlooks, shaped by history and habit, not to mention matters of prestige, preclude a rapid agreement. Nonetheless, the Europeans should work towards giving themselves a single voice, for the benefit of the rest of the world as much as themselves. If they can do it in trade, then why not on international financial questions?